

ILLINOIS POWER COMPANY

DOCKET NO. 00-0461

PREPARED DIRECT TESTIMONY OF

LEONARD M. JONES & MARK J. PETERS

JULY 7, 2000

I. WITNESS INTRODUCTION

1. Q. Please state your names, business addresses and present positions.

A. (Mr. Jones) Leonard M. Jones, Manager of Business Planning and Forecasting, Illinois Power Company ("Illinois Power," "IP," or the "Company"), 500 South 27th Street, Decatur, Illinois, 62521.

(Mr. Peters) Mr. Mark J. Peters, Control Area Resource Manager, Illinois Power Company, 500 South 27th Street, Decatur, Illinois, 62521.

2. Q. Please summarize your educational and employment background.

A. (Mr. Jones) I graduated from Western Illinois University with a Bachelor of Arts Degree in Economics in 1987. In 1988, I received a Master of Arts Degree in Economics, also from Western Illinois University. Since 1988 I have been employed by Illinois Power as a Rate Analyst, Senior Rate Analyst, Rate Specialist, and Team Leader - Costing and Economic Services in the Company's Regulatory Services Department. In November of 1999, I was promoted to my current position, Manager of Business Planning and Forecasting, in the Company's Business Development Services Department.

(Mr. Peters) I hold a Bachelors of Arts Degree in Liberal Arts and Science (Concentration in Economics) from the University of Illinois (1985). I began employment with Illinois Power in August, 1985 as an Assistant Customer Service Supervisor in our Champaign-Urbana office. I was subsequently transferred to our Finance Department in Decatur, where I held the following positions – Senior Financial Analyst, Remittance Processing Coordinator, Supervisor – Remittance and Administration, Financial Specialist and Financial Associate. While in the role of Financial Specialist in our Cash Management section, I successfully obtained my Certified Cash Manager credential. In 1996, I was transferred to our Energy Supply group as an Electric System Power Coordinator. In that function, I was responsible for the trading of real-time, hour ahead energy. In 1998, I was promoted to the position of Scheduling Coordinator. In this position, in conjunction with other Scheduling Coordinators, I was responsible for the short term management of both IP's physical assets and our financial trading portfolio. I traded energy primarily through the bilateral, over the counter market for periods of one day through one month. In 1999, I was promoted to the position of Commodity Pricing Manager within our Customer Services organization. In that function, I was responsible for the economic analysis of retail contract proposals, both within Illinois Power's current territory as well as opportunities within other service territories in Illinois. I also analyzed tariffs, market conditions and customer usage behaviors to determine ways for Illinois Power to profitably meet the needs of our current and potential customers. In January 2000, I returned to our Energy Supply group in my current

39 function of Control Area Resource Manager.

40 3. Q. What are your duties and responsibilities in your present position?

41 A. (Mr. Jones) I am responsible for performing or directing the completion of the
42 Company's annual load and revenue forecast, various economic analyses, and rate
43 and regulatory studies for the Company.

44 (Mr. Peters) I am responsible for the coordination of various resources
45 available to meet IP's load obligations. I am involved in contract negotiations,
46 review of invoices and modeling of load requirements and supply costs. Given my
47 prior experiences in both operations and retail structures, I am also actively involved
48 in various activities related to the development or modification of tariffs. Along with
49 others, I also represent the Company's interests in the Midwest Independent System
50 Operator, in the areas of Operations Support and Tariffs.

51 4. Q. Have you previously testified before the Illinois Commerce Commission ("ICC")?

52 A. (Mr. Jones) Yes. I previously testified in Docket No. 91-0335, regarding the
53 Company's electric marginal cost of service study; Docket No. 93-0183, regarding
54 the Company's gas marginal cost of service study; Docket No. 98-0348, regarding
55 the Company's proposed Rider DA-RTP II; Docket No. 98-0680, regarding the
56 investigation concerning certain tariff provisions under Section 16-108 of the Public
57 Utilities Act and related issues; Docket No. 98-0769, regarding requirements
58 governing the form and content of contract summaries for the 1999 Neutral Fact
59 Finder ("NFF"); and Dockets No. 99-0120/99-0134/99-0140 (cons.) regarding
60 delivery service rate design and Rider TC—Transition Charge for Non-residential

61 Customers.

62 (Mr. Peters) No.

63 **II. PURPOSE & SCOPE OF TESTIMONY**

64 5. Q. What is the purpose of your testimony?

65 A. The purpose of our testimony is to describe and discuss proposed Rider
66 MVI—Market Value Index. We will discuss the methodology used to create the
67 market price for energy for use in Rider TC—Transition Charge and Rider
68 PPO—Power Purchase Option Service. We also discuss how the market values are
69 applied to a customer's load or load profile. Ms. Voiles discusses changes to Rider
70 TC as well as the issues surrounding transitioning from using NFF values to using
71 Rider MVI.

72 6. Q. In addition to your prepared direct testimony are you sponsoring other exhibits?

73 A. Yes. We are sponsoring IP Exhibits 2.2 through 2.5, which were prepared by us or
74 under our supervision. IP Exhibit 2.2 is IP's revised Rider MVI—Market Value
75 Index. IP Exhibit 2.3 is a redline/strikeout version of Rider MVI showing proposed
76 changes from the version filed June 5, 2000. IP Exhibits 2.4 and 2.5 are described
77 further in our testimony.

78 7. Q. Why is Illinois Power filing a market value index tariff?

79 A. Mr. Breezeel addresses this in more detail in his testimony; however, we would
80 emphasize that the NFF process by its very design is likely to yield the correct
81 market value only by accident. Yet, the market values are very important in both
82 setting a customer's Transition Charge ("TC") and in setting the PPO price. If the

83 market values are not reflective of the actual market prices during the period they are
84 effective, and especially if they are too low by comparison to the actual market
85 prices, then competition is hindered. Currently, it is estimated that the NFF values
86 for 2000 are too low relative to the market. While we do not yet know what values
87 the NFF will publish for 2001, we do know that whatever they are they will be static
88 and will not change regardless of how circumstances may change after they are
89 published.

90 8. Q. Could you please elaborate on how competition is hindered if market values used to
91 set TCs are too low?

92 A. Yes. In vastly simplified form, the TC calculation begins with the customer's prior
93 bundled rates and then subtracts the customer's delivery rate, the market value of the
94 customer's power and energy and a mitigation factor. The customer's TC is the
95 amount remaining. Thus, if the delivery rate and the mitigation are held constant and
96 if the assumed market value is lower than it should be, the customer's TC is too high.
97 Since a marketer will presumably be paying the higher actual market price to obtain
98 electricity to resell and the customer will have to pay both its higher TC and the
99 marketer's higher actual electricity price, the customer will choose not to take service
100 from a marketer under this scenario. Rather, remaining on bundled rates or taking
101 PPO service from the utility (assuming the customer has a positive TC) are the
102 customer's only viable economic alternatives.

103 III. ILLINOIS POWER'S MARKET VALUE INDEX PROPOSAL

104 9. Q. In broad terms, how does the data used in Illinois Power's MVI proposal differ from

105 that used by the NFF?

106 A. The data used in Rider MVI provide more relevant information since it is more
107 current and, therefore, forms a better basis for establishing market prices than the
108 data used by the NFF. Further, such data more closely reflect the market in which
109 Illinois Power sells, and its customers buy, electric power and energy.

110 10. Q. Please provide an overview of how proposed Rider MVI works.

111 A. Rider MVI will provide for the determination of monthly On-peak market prices
112 from electronic exchanges (Altrade™ and Bloomberg PowerMatch) and a published
113 survey (Power Markets Week) that are accessible to market participants. On-peak
114 market values will be based on up-to-date Into Cinergy Hub forward prices on these
115 specified electronic exchanges and published survey results that are listed in
116 Appendix 1 to Rider MVI. Market values will be developed by obtaining daily
117 values for forward market data via a specified hierarchy on an as available basis.
118 Such On-peak market values will be adjusted by an appropriate basis adjustment to
119 reflect the regional market in which Illinois Power sells, and its customers buy,
120 electric power and energy. Off-peak market values utilize the most recent calendar
121 year's Off-peak prices for Lower MAIN from reports that are published daily.

122 11. Q. How often will the market value be updated?

123 A. Illinois Power will recalculate market values on a monthly basis to reflect up-to-date
124 forward looking prices and reduce the risk of price volatility. The On-peak market
125 data for the last five (5) consecutive Business Days of the second prior month and the
126 first five (5) consecutive Business Days of the prior month will be used to determine

127 the market values for each one-year period that commences the following month. On
128 or before the 8th business day of each month, IP will file Information Sheets with the
129 Commission and post on the Company's web site the market values for energy for
130 the On-peak and Off-peak periods for each relevant calendar month beginning with
131 the next calendar month following such 8th business day.

132 Using the 8th business day represents a change from the Company's June 5,
133 2000 filing, where the 15th day was proposed. Various parties who have commented
134 on the June 5 proposal recommended that customers be given a longer window of
135 time to evaluate their options in light of an updated market value, and thus transition
136 charge. Based on these comments, and a review of the internal process used to create
137 the market values and transition charges, moving the date from the 15th to the 8th
138 business day provides the customer additional time to evaluate its choices and still
139 provides the Company enough time to perform the necessary calculations.

140 12. Q. Will a customer's TC be updated monthly?

141 A. No. Once a customer commences Delivery Service, its TC remains in effect for the
142 next 12 billing periods, or Annual Period. The new monthly market values and TCs
143 would apply to prospective Delivery Service customers, or to existing Delivery
144 Service customers who reach the anniversary date of their Annual Period. Ms.
145 Voiles discusses some additional details on transitioning from a NFF based market
146 value to market values established through Rider MVI.

147 13. Q. Please explain the process used to create the On-peak value in more detail.

148 A. The On-peak market price is determined using forward contract market data for

149 electric power and energy delivered in the Into Cinergy Hub from Altrade™ and
150 Bloomberg PowerMatch—two real time, on-line, electronic trading systems that post
151 Into Cinergy Hub forward contract market data. In addition, On-peak market prices
152 also reflect market data obtained from “Power Markets Week”—a published survey
153 of market prices by region and contract period. In summary, this methodology relies
154 on actual transaction and bid/offer prices for power delivered into the region.

155 14. Q. Since Altrade™ and Bloomberg PowerMatch are interactive electronic exchanges,
156 how will market price data be gathered from these sources?

157 A. IP will poll Altrade™ twice per day, once in the morning between 8:30 a.m. and
158 10:30 a.m. and once in the afternoon between 2:00 p.m. and 4:00 p.m. Bloomberg’s
159 database will be queried for the relevant period.

160 15. Q. How does Rider MVI propose to calculate a Non Firm energy value?

161 A. The market value for On-peak Non Firm Energy for each month is equal to the
162 market value for On-peak Firm Energy for each month divided by 1.15. The factor
163 of 1.15 is related to the minimum planning reserve margin that utilities are directed
164 to have available by the North American Electric Reliability Council (“NERC”).

165 16. Q. How is the data from the various sources grouped into a single On-peak market value
166 for each month?

167 A. Proposed Rider MVI applies a hierarchy to how the data is used to create the monthly
168 On-peak values. First, actual trade data will be used whenever it is available for a
169 given forward contract for each month in the Applicable Period. Where multiple
170 trades are reported in various sources or on various days, those values will be

171 averaged (and, to the extent possible, weighted averaged by volume) to create a
172 single market value for that particular forward contract. Second, if one or more of
173 the information sources does not report an actual trade in a given day, it will not be
174 used and the other source(s) will be relied upon to create the market value. Third, if
175 only one source reports a trade on one or more days of the 10-day period when data
176 is being gathered, it will be relied upon to create the market value. Fourth, if none
177 of the data sources report an actual transaction, the average of the bid/offer prices
178 from each of the sources will be averaged with equal weight to arrive at the market
179 value for the given month.

180 IP Exhibit 2.4 shows examples of how the data will be grouped under the
181 various possibilities. Page 1 shows an example where trade information exists for
182 each information source. Page 2 presents the method for calculating market value
183 where information for some days in the 10-day period is missing. Page 3 illustrates
184 the methodology when only one data source contains information. Page 4
185 demonstrates the market value calculation when no actual trades exist and the
186 average of the bid/offer is used.

187 17. Q. Why did you choose the Into Cinergy index rather than some other index?

188 A. There were two considerations in choosing Into Cinergy: a) proximity to the IP
189 market, and b) relative level of volume trading on the index. The Into Cinergy Hub
190 is reasonably close to the IP service area. Market participants in Illinois commonly
191 trade in the Cinergy market. Additionally, the Cinergy market can be used as a
192 financial hedge for physical trading positions in the region through the application

193 of a regional basis differential. Second, we believe that the Into Cinergy market is
194 the most active hub relative to IP's service area. This opinion is based upon review
195 of published market news sources and discussions with IP's affiliated wholesale
196 marketer. We also believe this is supported, in part, by our sample model period of
197 April 24-May 5. During that 10 day sample, we observed at least 103 actual trades
198 in the sample and only one contract—April 2001—did not have any actual trades.

199 18. Q. Are you concerned about the liquidity behind the exchanges?

200 A. We are not currently concerned with the liquidity of the exchanges for several
201 reasons. The first is our belief that by proposing a "market basket" approach which
202 includes as many viable exchanges and data sources as allowed, we have diluted the
203 effect of having an individual exchange fail. By encouraging the future inclusion of
204 new exchanges and data sources, we believe that we will capture an even greater
205 percentage of the total market liquidity in our samples. Another reason that we are
206 not currently concerned with the liquidity of the exchanges is the relative longevity
207 of Bloomberg and the ongoing expansion of Altrade™. During our short experience
208 with Altrade™, we have noted the addition of several new participants. It is our
209 understanding that Altrade™ and Bloomberg are two common trading tools used
210 within the wholesale trading marketplace.

211 19. Q. Please describe the nature and accessibility of the two electronic exchanges you
212 propose to use with Rider MVI, Altrade™ and Bloomberg PowerMatch.

213 A. These electronic exchanges are basically on-line, interactive bulletin boards on which
214 qualified, enrolled market participants may openly post their willingness to buy or

215 sell various contracts for power and energy. Other qualified, enrolled market
216 participants may then choose to accept the posted bid/offer, thereby creating a
217 binding transaction, or to post counter bids/offers. These exchanges will list
218 contracts for various regions for different time periods, including one day ahead,
219 weekly, monthlies, quarterlies and annuals. The predominant contract which is
220 traded is for the 5x16, On-peak period. On occasion, an around the clock or Off-peak
221 contract may be posted. These exchanges are relatively low cost tools for trading
222 desks, and it would not be unlikely to have both available within a given trading
223 shop. The exchanges themselves are restricted to qualified, enrolled participants.
224 Historical trade data may be available to others at a subscription rate.

225 20. Q. Please describe the nature and accessibility of Power Markets Week ("PMW").

226 A. PMW is a weekly trade journal that includes, in part, a published survey of forward
227 market data. It is available to anyone for the price of a subscription (currently \$975
228 per year). The description of the survey provided by PMW reads in part as follows

229 "The monthly forward markets represent bilateral, over-the-counter
230 trades for on-peak power transacted for the entire month, unless
231 otherwise noted. Prices represent the lowest and highest deals
232 reported by market participants on a given transaction day."

233 It is possible that the same trade that was identified in Altrade™ or Bloomberg
234 PowerMatch could also be reported in Power Markets Week as the survey collects
235 data through a "daily survey of marketers, utilities and brokers." The survey,
236 however, attempts to cover a broader "over the counter" market than that which is

237 represented solely by the electronic exchanges.

238 21. Q. Why has Illinois Power chosen to use a "market basket" approach to data sources and
239 to put those data sources in an Appendix?

240 A. Taken together, the basket of index sources creates a reliable supply of information
241 that provides an adequate basis to establish a market value index. We believe that
242 it is more likely to capture a greater percentage of the over-the-counter volume and
243 reduce the ability of a single participant to bias the index. It also provides market
244 participants with a variety of sources from which to obtain information, so regardless
245 of their specific circumstances, they will have useful resources by which to track
246 changes in the most volatile piece of the market value. Furthermore, Illinois Power
247 has crafted Rider MVI to include only references to Appendix 1 so that as new
248 reliable sources of information become available, we will be able to add them by
249 altering the Appendix (upon proper approval from the Commission) and not have to
250 change the underlying tariff language when we do so.

251 In combination with our monthly updates of the market values, IP's proposal
252 surveys 120 business days worth of data from three sources each to arrive at market
253 values.

254 22. Q. Since the On-peak market values are not an "Into IP" value, has an adjustment been
255 made to the Into Cinergy value to convert it to an IP value?

256 A. Yes. A "basis" adjustment is made to the Into Cinergy market value to recognize that
257 while IP's and Cinergy's markets are closely correlated, they are not exactly the
258 same. The basis adjustment is equal to the quotient resulting from the division of the

values for the daily On-peak Lower MAIN Energy Price by the values for the daily On-peak Into Cinergy Energy Price for each of the 12 monthly contracts. The basis calculation will be performed annually using data from December 1st of the prior year through November 30th of the current year. All data are included in this calculation. This represents a small change from IP's June 5 filing (in which we proposed excluding data that were more than 4 standard deviations from the norm). This change was prompted by discussions with various parties and is reflected in exhibits 2.2 & 2.3.

23. Q. Please describe the process used to determine Off-peak market values.

A. The determination of market values for Off-peak periods is handled differently since there is no applicable Off-peak, regularly traded, forward market data. Calculation of Off-peak market values involves three steps. First, values for the eight-hour weekday Off-peak period are derived. Second, values for the 48-hour weekend period are derived. Third, the weekday and weekend values are combined to produce monthly Off-peak values.

24. Q. Are Off-peak prices as volatile as On-peak prices?

A. No, historically, although Off-peak prices show some modest movement between the summer season and the winter season, they have never been as volatile as On-peak prices which have experienced increased volatility in recent years.

25. Q. Please explain the development of weekday Off-peak prices.

A. Historical prices for the daily eight-hour Off-peak period from Monday through Friday for Lower MAIN can be obtained from McGraw Hill DRI or Platt's. These

281 data sources may be obtained for the price of a subscription to the service. IP will
282 use the published daily weighted average from this report. In the absence of such
283 data, the Company will calculate the midpoint between the minimum and maximum
284 trades for each day with reported prices for the respective month, and a simple
285 average of the midpoints for those days will be used for the Off-peak market price.

286 26. Q. How are the weekend prices calculated?

287 A. The weekend period value is the product of the weekday Off-peak period and an
288 appropriate seasonal correlation factor. The seasonal correlation factor is the simple
289 average of all PJM West Hub prices, by season, for the 12:00 a.m. Saturday through
290 12:00 midnight Sunday time period, divided by the simple average of all PJM West
291 Hub prices, by season, for the periods 12:00 a.m. to 6:00 a.m. and 10:00 p.m. to
292 12:00 a.m. Monday through Friday. The summer season is June through September.
293 All other months are non-summer.

294 27. Q. How are the weekday and weekend prices combined to arrive at the total Off-peak
295 values?

296 A. For each month, the weekday prices are multiplied by the number of weekday Off-
297 peak hours and added to the product of the weekend prices multiplied by the number
298 of weekend Off-peak hours. The sum of these products is then divided by the total
299 number of Off-peak hours in the given month to arrive at the unit price.

300 28. Q. How do the year 2000 market values for the NFF compare to the market values
301 effective for June using proposed Rider MVI's methodology?

302 A. IP Exhibit 2.5 summarizes the resulting market values of various load profiles for a)

the 2000 NFF, and b) market values created using proposed Rider MVI's methodology including the application of what has come to be known as the Zuraski, price shaping adjustment. This price shaping adjustment is actually performed within IP's Rider TC and is currently applied to the NFF values. The application of this factor is appropriate as it recognizes that suppliers are not able to purchase varying amounts of energy at a block price. Rather suppliers, with variable customer loads are faced with optimizing their block purchases, and either making incremental purchases for any shortfall, or incremental sales for any excess. This adjustment has the effect of increasing the market value for any customer who consumes proportionately more energy on-peak and decreasing the market value for a customer who consumes proportionately more energy off-peak.

In each case, proposed Rider MVI generates values greater than the NFF. The amounts ranged from a low of a 9.5 mil increase to a high of 15.1 mil increase. The average for the four profiles (107-small commercial, space-heat, miscellaneous; 207-small commercial, non-space-heat, miscellaneous; 307-medium commercial, space-heat, miscellaneous and 407-medium commercial, non-space-heat, miscellaneous) was a 13.6 mil increase.

IV. CHANGE TO RIDER TC

29. Q. Please describe the purpose of Section 7(d) of Rider TC and the proposed modification to that section.

A. Section 7(d) of Rider TC allows customers that have chosen to lock in on a transition charge for more than one Annual Period (as described in Section 7(c)) to purchase

325 an option to revoke the "transition charge lock-in." (Currently, customers cannot
326 choose this option since neither the NFF nor an index has provided market values for
327 more than the immediate year.) The fee for this option was to be sufficient to
328 compensate the Utility for the additional risk that results from actions taken with
329 reliance upon the Customer's notification. When the customer notifies the utility of
330 its intent to enter into an extended period Transition Charge, the utility is faced with
331 a possible loss if the utility would release or otherwise sell to another party the
332 capacity and energy which it otherwise would have sold to the original customer.
333 Should that customer subsequently cancel such notice, the utility must reacquire
334 capacity and energy at current market prices. It is not reasonable to expect the utility
335 to continue to maintain sufficient capacity and energy for this customer, without
336 compensation, based on the possibility that it may choose to revoke its notice. In
337 effect, the fee should be sufficient to allow the utility to purchase a similar option in
338 the open market and protect itself against possible loss. Since IP intends to actually
339 purchase an offsetting option, it is incurring the additional risk of counterparty failure
340 and execution risk. As was extremely evident in the wholesale markets in the
341 summer of 1998, the risk of counterparty failure is very real and represents a
342 substantial potential cost. It is for this reason along with the additional
343 administrative burden associated with processing the transaction, that the Company
344 has asked for the higher of \$100 or 2% of the transaction amount as an administrative
345 and risk management fee in excess of the actual option premium.

346 It is important to note here that the Company does not intend, nor desire, to

347 make a profit from this transaction. Rather, Illinois Power is only seeking to hold
348 itself whole from a cost and risk basis for providing this service to a customer. Since
349 the fee received from the customer is intended to be used to purchase an offsetting
350 option from the market place, the Company has nothing to gain from attempting to
351 manipulate the price.

352 The language in Section 7(d) now calls for the Company to solicit at least 5
353 bids for such an option. The solicitation for bids would describe an instrument which
354 Illinois Power seeks to purchase to hedge the risk it faces due to a customer canceling
355 their notice. It would list a strike price, equivalent to the customer's MVI value used
356 in the TC calculation and a kWh amount reflective of the customer's monthly
357 demand characteristics and would define the Company's exercise rights.

358 The Company believes that this method of determining the fee for the
359 customer's option is reasonable. It will provide the customer with an accurate cost
360 of obtaining such a right, while protecting the Company from undue risk. We
361 understand, however, that an instrument of this nature is not common for transactions
362 of relatively small size and welcome suggestions for an alternative means of
363 determining this fee which meet the goals of accurate costing for the customer and
364 risk mitigation for the Company.

365 30. Q. Does this conclude your direct testimony?

366 A. Yes.